

Energy Decision Making

**Joseph P. Tomain
Sheila S. Hollis**



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**The Interaction of
Law and Policy**



Joseph P. Tomain

Drake University

Sheila S. Hollis

Butler, Binion, Rice,

Cook & Knapp



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**Energy
Decision
Making**

*To Windsong, John, and Emily—for
your generous love.*

*To my parents,
Joseph and Bernice Tomain.*

Acknowledgments

How the federal government makes decisions concerning natural resources used to produce energy is the subject of this book. *Energy* is defined as the capacity to do work, and, aside from the work of the authors, the energy of others must be gratefully acknowledged.

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Introduction

Energy, and the issues of its availability and price, has been prominent in the public consciousness for less than a decade. Prior to the Arab oil embargo in October 1973 the only publicly discerned or recognized central-government policy regarding energy was to assume the continued supply of cheap abundant resources to feed the needs of the energy-hungry country. About 1970 policymakers awakened to the possibility that domestic supplies of cheap, readily obtainable energy were disappearing. To supplement declining domestic supplies and satisfy increased national demand, the nation became increasingly dependent on foreign-energy sources. That dependence, although reduced, continues today, and our government's energy decisions during the past decade directly reflect perceptions of the magnitude of that dependence.

When supplies of energy were abundant and costs were relatively low, government regulation affecting energy was generally effected through common-law doctrine, that is, judge-made case law. Doctrines such as those of prior appropriation and the rule of capture were created and administered by the states. The primary purpose of these laws was the protection of a particular state's (usually a producing state's) interest in a particular resource. The rules developed to conserve the oil and natural-gas supplies of the state while encouraging proper drainage of hydrocarbon reserves. This disposition of energy resources provided a predictable flow of these fuels into the American economy. The philosophy of conservation through controlled production dominated the 1950s and 1960s. After a tumultuous attempt to reshape totally energy policies by the Carter administration, the simple formula of the past is once again a comfortable port to which the Reagan administration is returning. Prior to the 1970s, the role of the federal government in many areas was relatively pedestrian and had minimal effect on the development of many natural resources. However, energy in the 1970s finally became a power issue—one that engendered public controversy and demanded resolution of conflicts in goals and methods. Although historically the federal government generally had limited its role to the regulation of sales and transportation of some energy resources in interstate commerce, particularly wholesale sales and transport of electricity and natural gas, suddenly the federal government became the focal point of virtually every aspect of decision making in the energy business. From initiation of exploratory activity to the burning of a unit of energy in the consumer's oven, most steps in the process were affected by federal laws and regulations. Exceptions to the *laissez-faire* noninterventionist approach of the 1950s and 1960s were numerous, however, particularly in times of

war or other major emergencies, when regulation reared its controversial head.

Since 1970, the publicly perceived scarcity of domestic supplies, deep concerns about the security of the traditional foreign-energy-supply sources together with severe doubts about the stability of the international energy supply-and-demand pool, have provided the fertile base for the growth of the role of the federal government in the control of energy policy. Although the Reagan administration has attempted to shift attention away from the so-called energy-scarcity mentality and from fear of reliance on foreign-energy sources, the energy issues that precipitated strong regulatory reactions in the Nixon, Ford, and Carter administrations have not suddenly evaporated. Rather, the authors believe that these issues are artificially dormant for the moment. If any major supply interruption from foreign sources were to occur or if demand for energy increased significantly more rapidly than predicted today, the federal government would be forced to respond to chaos. The chaos would revolve around the equitable distribution of diminished oil supply and the economic adjustments necessarily attendant to vast price increases in a supply-constrained environment. A belief that the marketplace can resolve every problem including the critical supply shortage is misplaced. The present administration should not ignore history and rely on the market to ensure even the roughest justice in the distribution of hardship and burden in a supply crisis. Thus, dismantlement of virtually all institutional structures to deal with supply interruption is a simplistic answer to complex issues of governance of the nation in an area of fundamental importance. This observation does not assume that the world has not changed since the embargo of 1973 and the fall of the Shah of Iran in 1979. United States reliance on imported crude has dropped significantly. However, even now 40 percent of our supplies come from foreign sources that, in large part, cannot be considered secure.

It is in this context, then, that this book studies how the federal government makes decisions that affect the allocation and distribution of energy resources in times of scarcity or plenty. At first glance a book on federal regulation of energy may seem outdated before it is published, because laws and regulations change at least with every new administration and major technological advance. Nevertheless, a system and structure by which decisions are made about energy policy, administration, and enforcement of energy-related law is discernible. The purpose of this book is to examine that underlying structure. It is the belief of the authors that the basic energy-decision-making apparatus is in place (even if in exile) and will continue to be called on in the future as the matrix in which decisions will be made. Although it is not a perfect decision-making mechanism, it can work—albeit sometimes in spite of the om-

nipresent political influences on the process. Furthermore, we believe that energy issues and the government's response to them are reflective of issues in larger society. The topic of this book is an example of how a legal system responds to our society's technological consciousness in the formulation of energy policies. We also examine the long-term implications of that pattern of periodically perceived crises and government's response to them.

Energy policy is the product of complex, overlapping, uncoordinated sets of decisions by all levels and branches of government. It is affected in the most basic sense by factors outside the control of government, including actions of foreign countries, multinational corporations, and marketplace and consumer reaction to political and economic realities. A truly comprehensive energy-policy study, if one were possible, would encompass energy-related decisions made by foreign governments as well as state and local governments. However, this book focuses on the decision-making apparatus of the U.S. federal government.

The book is written by two lawyers. This caveat is given to indicate our particular world view. Our hope is that a larger audience may find our analysis useful. For lawyers, the book will give a political overview of how policies are made in the legal framework we discuss. For the nonlawyer, such as the public official, student of government, industry manager, or layperson we discuss the legal variables that necessarily affect energy decision making.

We look at one public policy area—energy. The energy story as it unfolds in this book has many facets. We take a unique look at it herein—as children of the sixties and as young lawyers of the seventies we have been endeared to a conception that substantive policies of continuity and universal approval are more important than technicalities, more valuable than procedural niceties, and more meaningful than mere processes. Yet, because of the rapidity of change in national and world economics and markets, domestic and international politics, and scientific and technological advances, energy policies cannot be based on universal truths—they are anything but static. For us to make sense of the policymaking process we resorted to comfortable lawyers' territory: looking for structures, not categorical truths, used to decide a universal and critical issue: how to supply the need of our society for energy. Energy has been defined as the capacity to do work. Thus, for our society to work, we must explore the methods by which government encourages or dampens the fulfilling of the need for the catalyst of economic activity—energy. These structures are for the most part fairly static institutions. The energy laws grafted on to the structures change continuously. We, as lawyers, seek solace in the fact that the process by which those laws are formulated, implemented, interpreted, and changed is more predictable.

Thus, our book is about processes of decision making. Part I examines the institutional structures through which energy decisions are made. Within those structures certain methodologies are used to make decisions, and these methodologies are the subject of part II. The final part of the book discusses the types of values inherent in these institutions and methodologies, which are thus reflected in substantive rules and decisions. Lest the reader think that this is a sterile account of legal apparatus we caution that we do not believe that processes are contentless, that institutions are devoid of human failings and aspirations, nor that processes are not often policy determinative. An undercurrent of the book is that the way institutions are structured is reflective of the human values that structured them, and consequently form and process belie the substantive tensions and pulls within any policy. This book describes the energy decision-making process and speculates on the inherent tensions within these processes that have and will affect whatever policies are developed.

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Part I
The Institutional Structure of
Energy Decision Making



1

Administrative Law

Energy decision making involves all branches of government—the executive, legislative, and judicial. Less visibly but often more importantly, energy decision making occurs in significant part through the less widely known fourth branch of government, the administrative agencies. This latter branch is the primary focus of this book’s exploration of the unique way decisions about energy are made in the United States. We have noted the power issue inherent in energy decisions. The natural attraction to power and jurisdiction over major decisions is a *raison d’être* for government officials’ involvement and final actions. This is painfully evident in any study of energy decision making. The undercurrent of desire for power to decide society’s major issues is a pervasive theme of our analysis.

Agency Life Cycle

Administrative law has developed in recognizable cycles. How these cycles are revealed in the field of energy law will be explored in part I. The regulation of any industry, in this case a complex system of producers, transporters, distributors, and sellers of energy, starts from the presumption that an industry is best left unregulated and operating in a natural market state. The free market, the hope goes, is the best mechanism for setting prices and allocating resources. If, however, for some reason the free-market mechanism does not run as smoothly as hypothesized, if prices do not respond to demand, if a particular class of consumers is severely injured by the market, or for other policy reasons, then some government policymakers assert the existence of a market failure to justify stepping into the system to correct the apparent market defect. Corrective measures are applied to an industry with the hope and intent of approximating the efficient precision and workings of the free and competitive market, that state where the supposed inexorable laws of Adam Smith fulfill the aspiration that the greatest happiness will be accorded to the greatest number.¹ Once an instance of market failure is found then government policymakers seek a regulatory tool to remedy the ill. These regulatory tools in their broadest classification are (1) those designed for economic regulation, in which case economic efficiency is the goal, and

(2) those designed for social regulation, where the goal is fairness or equity.

The effectiveness or efficiency of the regulatory program elected naturally depends on its inherent appropriateness as a tool to remedy the perceived malady. By its very nature the structure of administrative law imposes costs (transaction costs) on the regulated industry and on the government and citizenry in the form of administration, recordkeeping, compliance programs, and studies of government actions. As part of the economic system of society, members of society who use the industry's service or product also share in the transaction costs. These transaction costs can have the anomalous effect of increasing the inefficiency of a market rather than decreasing it if the regulatory device selected is inappropriate for the task or if it is poorly administered. The costs (in efficiency, fairness, or both) of administering a program can outweigh its potential gains. If that is the case then we have an example of regulatory failure—the regulatory device simply does not work—the door has so many locks on it that it falls of its own weight. Basically, two choices are available at this point. The arm of government can choose to deregulate an industry or segment of an industry (as in the case of the decontrol of crude oil) or the government can undertake some type of regulatory reform. In the chapters to come we will discuss the predicate for regulation, the regulatory tools available to correct instances of perceived market failure, the regulatory tools available to deal with the fault in the system, reasons for failure of those regulatory devices, and possible ways to correct the breakdown of the regulatory process.

A Short History of Administrative Law

The most significant, and perhaps intractable, contribution that the United States has made to world legal systems is administrative law. Virtually no citizen, let alone lawyer, can escape dealing with administrative agencies at some level of government on a daily basis. Agencies and their outpouring of paper and politics pervade our legal structure and fashion our lives in the most fundamental respects. In the realm of energy resources, the prices of oil, gas, electricity, coal, and renewable energy are directly and indirectly affected by the actions of such federal agencies as the Department of Energy, Treasury Department, Department of Interior, and departments of Commerce and State. Your electric or gas bill essentially is the product of decisions by your local state public-utility commission. More law is made by administrative agencies and departments than by the courts and Congress combined. The total dollar value